

The Impact of Tax Audit and Investigation on Revenue Generation in Nigeria

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Abstract

This study examines the impact of tax audit and investigations on revenue generation in Nigeria. The aim is to determine if tax audit and investigations can actually increase the revenue base of the government and if it can also stamp out the incidence of tax evasion. Data were collected through the primary sources from four hundred and ten respondents who are staff of the Federal Inland Revenue Service and Edo State Board of Internal Revenue. Hypotheses formulated were tested with Pearson Correlation Coefficient using SPSS output data. The findings are that Tax audit and investigations can increase the revenue base of the government and can also stamp out the incidents of tax evasion in the country. It was recommended that Tax audit and investigations should be carried out more often and as thorough as possible to accomplish its task of increasing the revenue base and stamping out tax evasion in the country.

Key Words: Tax Audit, Revenue Generation, Investigation.

Introduction

The issue of taxation is as old as the world itself. Tax Audit and Investigation has been known since the biblical era. Yet, many are never comfortable discussing taxation, worse still Tax Audit and Investigation. To deter evasion and maximize compliance with tax laws is key in government's Revenue Policy. One of the aims of Tax Audit and investigation is to drive the taxpayer to comply with the outcome of tax audit investigation and also to make him become compliant with the provisions of tax laws in future. That is why the terms have become synonymous with the efforts of government to generate Revenue.

In the last couple of years tax audit and investigation has been a critical issue often discussed in Nigeria. The tax authority has had lots of sleepless nights, trying to review the books of the tax payers with the sole aim of increasing the revenue of the government. The question is to what extent has tax investigation and audit contribute to the revenue generation in Nigeria?

Objectives of the Study

This study aims at achieving the following objectives.

1. To investigate if there is any significant relationship between revenue base of the government and tax audit and investigation in Nigeria.
2. To investigate, if tax audit and investigation can aid in resolving the problem of tax evasion in Nigeria.

Literature review

Tax Audit and Investigation

The Nigeria tax system has failed on the area of its administration. Personal and company income tax administration in Nigeria today do not measure to the appropriate standard. The self-employed persons earn more than those in paid employment. The self-employed earn four times than those in paid employment but the bulk of personal income yield comes from those paid employment whereas those who are self-employed earn most of the money. As a result of inadequacy in monitoring taxes paid, lots of those who are self-employed evade tax. These thus call for the need for a good and standard tax audit and investigation. Tax audit and investigation in Nigeria are terms which embrace a variety of sectors. It simply means the advanced part of auditing practice that involves examination of books of account in order to check if the assessable profit showed by the tax payer is correct.

The benefit of tax audit and investigation is to create genuine revenue for the federal, state and local governments through different basis which are: Company Income Tax, Personal Income Tax for the resident of Abuja, Nigeria Diplomats and member of the Armed Forces, Petroleum Profit Tax, Education Tax, Withholding Tax, Value Added Tax (VAT) and Pay As You Earn (PAYE). (Olusola, 1998).

It is expedient to say that if professional examiners are not in place as a control over the taxpayer; the government will not actualize its aims and objectives. The taxpayer is a dodger when it comes to the issues of tax

payment. He therefore needs to be motivated seductively or by force into paying what is expected from him. The taxpayer is always unwilling to pay his tax liability. The use of tax audit has however helped in the generation of revenue to the government.

Tax Audit

Tax audit just like financial audit involves the gathering of information and processing it for determining the level of compliance of an organization with tax laws of the territory. For a successful audit, it is necessary that the auditor organizes his work in such a way that the assignment is accomplished completely and efficiently. More importantly however, a professional tax auditor or investigator must possess sound accounting and taxation knowledge, he must be sharp in interpreting the tax laws, tactical and must display high intelligence in applying tax laws, he must have sound knowledge of investigation techniques. Apart from technical skills, he must be alert and open minded with good communication Skills. These are necessary personal prerequisite for any tax auditor or investigator to be successful for tax audit assignments. A tax as we already know is a charge imposed by governmental authority upon property, individual or organisation to raise money for public purpose. An audit on the other hand can be seen as the examination of the records underlying a financial statement as will enable the auditors to report authoritatively, whether in his opinion, the statement gives a true and fair view. (Izedonmi2000, Okoye, 2006)

Adesina (2005) defined an Audit as the examination of accounting documents and of supporting evidence for the purpose of reaching an opinion concerning their propriety. It is an examination intended to serve as a basis for an expression of opinion regarding the fairness, consistency, and conformity with accepted accounting principles of statement prepared by a corporation or other entity for submission to the public or to other interested parties. Tax audit is therefore a means of ensuring compliance with the tax laws. The primary purpose of tax audit is to maintain the confidence in the integrity of the self-assessment system. It helps to improve voluntary compliance by detecting and bring to book those who do not pay the correct amount of tax.

One of the cardinal principles governing the tax audit program is that each line of grade or business should receive at least a nominal amount of audit attention. The selection of times for audit is management decision and criteria used vary from time to time. (Ola: 1999).

The idea of tax audit became known through Lagos state where monitoring agents were appointed to carry out tax audit on government behalf. These monitoring agents mostly Chartered Accountants who are performing the function of carrying out tax audit of PAYE. The functions of these monitoring agents however was taken over by tax consultant in 1996 and their mode of operations different from that of monitoring agents. It has become fashionable for state government to carry out tax audit exercise in order to fulfill all righteousness that the actual tax due to the government have been deducted and remitted to the government account (Ojo, 1998).

This exercise has however received some credits which are;

1. Making the taxpayer conversant with the applicable tax laws
2. The rate at which the taxpayers comply with tax laws has been increased.
3. It has added depth to the Nigeria tax practice
4. The revenue of the government was increased.

The tax audit may be varied by way of desk or room audit or field audit.

Desk (or Office) Audit

This is one which the whole activity of the audit takes place within the confines of the office of the tax officials. In this situation the tax official may simply request the taxpayers to provide some additional documents to his office to enable him clear some issues in the returns submitted.

In this type of audit, no official notice is given to the taxpayer of the impending desk audit exercise. He only gets to know when letters are written to him requesting for certain documents or explanations. The essence is to ensure some level of compliance with tax laws, rules and regulations as well as performing the administrative checks on returns submitted.

Field Audit

By the nature and scope of their work, regular assessing officers can only carry out limited desk audit through examination of accounts and returns. It is in a bid to check this handicap as well as to improve on tax compliance that tax authorities carry out field audit exercise on taxpayers by physically conducting the exercise in the office of the taxpayer. The taxpayers are however formally notified of the arrival of the auditor prior to the commencement of the audit and the requirements of the auditors in terms of documents to be audited will also be requested for in advance. Field audit involves physical verification of documentary evidence and materials at the premises of a taxpayer so as to confirm the facts and figures of the tax returns filed by corporate taxpayers. The scope or depth of verification depends on the outcome of the desk audit work carried out by the tax auditor as

well as the risk factors of the audit exercise. Special attention will normally be paid to those items likely to have high tax yield potentials. The tax audit is normally carried out through the back duty audit.

Back Duty Audit

Back duty audit may be instituted when the following occurs:

1. Failure to disclose or include in full any income or earning in the return made available to the tax office.
2. Doubtful claim of capital allowance in respect of current or previous year.
3. Reduction in the profit in the returns files in tax office
4. Where the tax charged or assessed is less than what it ought to be.

The institution of back duty audit on a taxpayer can either be a routine or as a result of the above reason. It is an exercise by the relevant tax authority to ensure that the amount due to the government is duly collected. (Ariwodola, 2000).

Condition For A Good Tax Audit

For the tax inspector to carry out a good audit exercise, the following conditions must be fulfilled.

1. The tax auditor must be familiar with the environment in which he works. It is a condition which is highly critical that the tax inspector must be properly schooled in the political, economical, social, cultural and religious environment of the taxpayer. A good knowledge of his environment will affect the decision made by him.
2. The tax officials should be motivated to carry out tax audit, he should be properly trained and have experience in his area. The tax inspector should not be carried away by corrupt practices that render the aim of the tax audit useless.
3. The tax audit should be properly supervised by those who are professional and when new tax inspectors are sent to carry out the audit, they should be monitored by older ones so as to make sure that the right thing is done.
4. Specialization should be encouraged. The cases should be grouped. This will allow the tax audit staff to become specialist in specific field.
5. The manner in which the audit is being carried out should be changed. The use of computer should replace the manual process as this will go a long way in facilitating the job and helping to preserve information for a long time. This will improve the efficiency of the exercise (Ogundele, 1999).

Issues in tax audit and investigation

A number of issues are often mentioned when discussing matters relating to Tax Audit and Investigation. They are so persistent that they cannot just be ignored. A modest effort will hereby be made to address some of these contemporary issues related to Tax Audit and Investigation. Some of these are summarized below:

A. Responsibility for the result of Tax Audits

The result of a tax audit is enforced by holding the employer responsible for any tax liability arising from the tax audit of the employees. In a situation where some affected staff (local and expatriates) might have left the country by the time of the audit there is always a debate as to who should be held responsible. This debate is quite unnecessary as the law is clear on who should be held responsible. Section 81 of the Personal Income Tax Acts (PITA) as amended to date recommends that where an employer fails; "to make the deduction or properly to account therefore, the amount there together with a penalty of 10% per annum of the amount interest at the prevailing commercial rate shall be recoverable as a debt due by the employer to the relevant authority". Thus it is the duty of the appointed collection agent or an employer to fully account for what it had deducted, or ought to have deducted, on behalf of the relevant tax authority.

- B.** Definition of Income. Chargeable Income is defined in Section 3 (1) of the PITA as the income of a person "from a source inside or outside Nigeria" and it includes any gain, profit salary, wages, fee, compensation, bonus, premium and almost all conceivable allowances but excluding some reimbursable expenses and compensation for loss of office. In some cases, only basic salary is included by the employers while other taxable allowances like bonus, appropriate portions of rent and transport allowances and leave pay are wrongly excluded from taxable income. In the oil industry where the compensation package is robust, exclusion of relevant income and allowance has the tendency of gross understating PAYE taxes and remittances to the respective state government. The normal audit approach is to re-compute the taxable income and tax therefrom with a view to recovering possible underpayments, if the collection agents have previously been computing the taxable income as stipulated by the Act, there would have been no need for elaborate tax audit.

C. Focus on Revenue Generation

It is often said that the customer is always right, this is however not the case in the relationship between the tax authority and the taxpayer. This is so because the major aim of tax audit and investigation is not to manage the taxpayer but a focus on generating revenue. (Ojo, 1996).

- D. Artificial Transactions, Global Income, Expatriates and Deemed Income. Taxable incomes of expatriates in the oil industry are most often grossly understated. This emanates from the fact that the revenue accruing to oil companies are partly received offshore from which expatriates are also partly paid offshore. The part of an expatriate's income paid offshore is always hidden from the tax authorities. This is an illegal practice given that what is taxable in Nigeria as stipulated by Section 3 (1) of the PITA is the income "from a source inside or outside Nigeria". In other words, an expatriate is expected to pay tax on his global income here in Nigeria irrespective of how and where the income is received provided the work is performed here in Nigeria. In order to ensure that government is not short-changed as a result of this, the tax auditor usually has no choice than to invoke the provision of Section 17(1) of the PITA. which states that where a tax authority is of the opinion that any transaction which reduces or would reduce the amount of any tax payable is artificial or fictions, the tax authority may disregard the disposition or direct that such adjustments shall be made as respect as the income of an individual so as to counteract the reduction of liability to tax affected."

This is done by substituting the declared taxable income of the expatriate with reasonable deemed income which in most cases is computed by assigning the naira equivalent of the minimum wage or the average unemployment benefit in the country of origin of the expatriate concerned. This is based on the assumption that no rational expatriate (who might have come from a country more developed than Nigeria) will accept a job that will fetch him less than the minimum wage (or unemployment benefit) in his country. in some cases, where the tax auditor has reasons to believe that income of local staff in a company is understated, the concept of deemed income may also be applied, in the oil industry for example, there are many off-payroll benefits paid to local staff. Such benefits include furniture grants, dress allowances and housing grants that are not meant to be refunded. All these are always not included in the taxable Income of the employees hence the justification for applying the concept of deemed income in this instance. The application of "deemed income is a recent development in tax audit which the private sector detests.

E. **Recovery of debt due to the State Government**

One of the recent developments is the sealing-up of business premises so as to recover liabilities or debts due to the State Government (e.g. Edo State) arising from tax audits. The critics of this particular method often claim that such a method is not in line with provisions of Section 96 of the PITA. It should be realized that the section provides that the tax authority may, in the prescribed form, for the purpose of enforcing payment of the tax due detain upon any land, premises, or place in respect of which the taxpayer is the owner. If the defaulter in question is the taxpayer, the most practical way his immovable property can be detained is by sealing it up. In the case that the defaulter is not the taxpayer but his employer who failed to remit government what it has deducted, or refused to deduct that which it ought to have deducted on behalf of the government, the issue is that of debt. This is recoverable "as a debt due by the employer to the relevant authority" as per Section 81 of the PITA. As the Act is silent on how the government should go about recovering such debts, sealing up the premises of recalcitrant debtor cannot be said to be a contravention of the PITA provisions particularly if it is done after an order from a court of competent jurisdiction.

Methodology

The data for this study were generated from primary sources through the use of five hundred questionnaires administered to the staff of the Federal Inland Revenue Service (FIRS) and Edo State Board of internal Revenue, Edo State of Nigeria. Four hundred and ten questionnaires were properly filled and returned. The returned questionnaires were then analysed using Pearson's correlation coefficient with the Statistical Package for Social Sciences (SPSS). The result of the analysis and the hypotheses tested are presented below.

The Respondents were asked whether there is any significant relationship between increase in the revenue base of the government and tax audit and investigation. The response to the question is presented in table 1 below: **Table 1**

The Relationship between Revenue base of the Government and Tax Audit and Investigations

	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	390	95.1	95.1	95.1
No	20	4.9	4.9	100.0
Total	410	100.0	100.0	

Source: field survey, 2013

From the table 1 above 95.1% of the respondents are of the opinion that there is a significant relationship between increase in revenue base of the government and tax audit and investigations. The remaining 4.9% of the respondents are of the opinion that there is no significant relationship between increase in the revenue base of the government and tax audit and investigations.

Ho₁: There is no significant relationship between the increase in the revenue base of the government and tax audit and investigations in Nigeria.

To test this hypothesis, the response of the respondents in table 1 was subjected to Pearson's correlation analysis using SPSS. The result is presented in table 2 below:

Table 2:
Correlations of the Relationship between Revenue base and Tax Audit

		Revenue Base	Tax Audit
Increase in Revenue Base	Pearson Correlation	1	.297
	Sig. (2-tailed)		.063
	N	41	40
Tax Audit and Investigation	Pearson Correlation	.297	1
	Sig. (2-tailed)	.063	
	N	40	40

Source: SPSS Output

Decision rule: when the correlation figure is negative, we accept the null hypothesis. However, if the figure is positive and tends to 1, it means that there is a correlation between both variables and the null hypotheses should be rejected.

Decision: From the SPSS output above, we can see that the correlation is positive with 0.297, therefore the null hypothesis is rejected. This simply signifies that there is a relationship between increase in revenue base of government and tax audit and investigations.

The respondents were again asked whether tax audit and investigations could reduce the problem of tax evasion in Nigeria. The response to this question is presented in table 3 below:

Table 3
Tax Audit and Investigations and the problem of Tax Evasion

	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	380	92.7	92.7	92.7
No	30	7.3	7.3	100.0
Total	410	100.0	100.0	

Source: Field Survey 2013

From the table above, 92.7% of the respondents are of the opinion that tax audit and investigations aid in resolving the problem of tax evasion in Nigeria. The remaining 7.3% of the respondents are of the opinion that tax audit and investigations do not aid in resolving the problem of tax evasion in Nigeria.

Ho₂: Tax audit and investigations do not aid in resolving the problem of tax evasion in Nigeria.

To test for this hypothesis, the response to question 10 from the questionnaire was subjected to Pearson's correlation analysis using the SPSS. The result is presented in table 4 below:

Table 4
Correlations of the Relationship between the Audit and Tax Evasion

		Revenue Base	Tax Audit
Tax Audit	Pearson Correlation	1	.297
	Sig. (2-tailed)		.089
	N	41	39
Tax Evasion	Pearson Correlation	.296	1
	Sig. (2-tailed)	.089	
	N	39	39

Source: SPSS Output

Decision rule: when the correlation figure is negative, we accept the null hypothesis. However, if it is positive and tends to 1, it means that there is a correlation between both variables and the null hypotheses should be rejected.

Decision: From the SPSS output above, we can see that the figure is positive with 0.276. This simply means that there is a relationship between Tax Audit and Tax Evasion. We therefore reject the null hypothesis which means that; Tax audit and investigations aid in resolving the problem of tax evasion in Nigeria.

Summary of Findings

From the study, it was discovered that it is necessary to pay taxes and that the Tax system in Nigeria is not efficient. It was also discovered that the attitudes of the tax payers are not encouraging and that tax evasion and tax avoidance have done more harm than good to the tax system. Also discovered is that Tax Audit and Investigation can lead to an increase in Government Revenue to a great extent. The study equally reveals that Tax audit and investigations can help to curb the problems of tax evasion and tax avoidance to a great extent. Also revealed is that to a great extent, Tax audit and investigations serve as motivating factors to the tax payers in carrying out their tax obligations in Nigeria and that tax audit and investigation can be regarded as the solution to Nigeria tax problems.

Conclusion

Tax audit and investigation should be embraced as it has a dual purpose or benefit: On the part of the taxpayer, it serves as a check on the proffers guiding tax administration and also helps in strengthening the activities of the taxpayer. To the authorities, it maximizes the collection of revenue which enables the government addresses developmental projects that will benefit its citizenry. Generally, it serves as a reminder to all parties that it does not pay to engage in deliberate tax evasion. Tax audit and investigation are critical to causing the tax payer to be on their toes. This is particularly true for the taxpayer who is marginally complying and can easily be moved to the realm of tax evaders. Tax audit and investigation is also a means to protect government resources and make sure that defaulters do not go free for their offences.

Recommendations

Based on the findings of this study the following recommendations are made;

1. Tax auditing and investigation should be carried out more often and as thoroughly as possible so as to bring down the rate evasion and avoidance of tax to the minimum.
2. The tax payers should be educated and enlightened as to importance and benefits of taxes to them and the economy at large.
3. Tax collected by the government should be properly used. This will go a long way in encouraging tax payers to be more faithful.
4. People engaged by the government to carryout tax investigation and audit should be men and women of high integrity and should be well trained and motivated so as not to compromise their stand.

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